



Creating a Global ESG Market Standard
for Owners, Lenders, Borrowers and
Impact Creators

Transparency Update

Presented by Dr Radek Stech, Founder and CEO, Global PSSSL,
at the invitation of the Bank of England
Securities Lending Committee

Thursday 4th November 2021

CITATION: Radek Stech, '*Sustainable finance principles and securities lending: a transparency update*', Presentation delivered at the Securities Lending Committee of the Bank of England, 4th November 2021 (Global PSSSL 2021).

Thank you very much for the invitation – I am truly honoured.

Today I will focus on broad ESG and market trends and provide a transparency update on securities lending through the lens of voluntary principles. If you'd like to visit gpssl.org, you'll be able to read about the principles and market standards we've been creating with stakeholders.

A. Sustainable finance principles

1. Nature and importance

I will draw on my broader sustainable finance expertise and my early research contacts with the World Bank for this section of my presentation.

The voluntary principles-based approach in sustainable finance has been used for a long time to achieve specific ESG-related outcomes and influence the industry's behaviour for those outcomes. These include Equator Principles for project finance, Green Bond Principles for bond finance, Global PSSL for securities lending and UN Principles for Responsible Banking. The nature of the principles is to guide industry and provide a direction for more detailed technical work. They also provide industry with a roadmap to implementation, continuous improvement and a verification of progress. In other words, principles constitute a pathway to execution.

2. Principles and law

Broadly speaking, the principles-based approach often forms part of a legal regime, especially in common law or European Union Law. When the principles fail (e.g. through diverse judicial interpretation), legislators or regulators impose rules. In international and domestic environmental law, some principles were adopted as binding by legislators/regulators (notably, the 'polluter pays principle'). Similarly in sustainable finance, we have seen legislators/regulators learning from Green Bond Principles or, recently, Global PSSL.

There are numerous incentives to embrace and implement principles which are appropriate for the whole community of stakeholders, e.g.: lower costs of compliance, action without cumbersome binding regulation and gains in innovation. However, there may be high costs, if the stakeholders pay a lip service to the principles or choose Principles that do not particularly fit those stakeholders (I shall talk about this in a moment).

3. Principles and sustainable finance:

- top-down approaches;
- bottom-up approaches.

As you know, I have worked on promoting a principles-based approach for securities lending since 2018. As part of this work, I co-organised a workshop with Aberdeen Standard Investments on 20 March 2019, where I argued:

"There is a clear need for SF [sustainable finance] principles in securities lending because this is a complex finance dynamic (CFDs), which is governed by a series of legal deals and depends on the collaboration of several key players. Thus, it is insufficient to rely on the existing broad principles such as the Principles for Responsible Investment (PRI) which focus more on organisational practices rather than CFDs. We should strive to align with developing

global agendas; co-create the principles and make them adaptable to different contexts and jurisdictions.”¹

PRI and UN PRB are examples of top-down approaches that target broad organisational/investment practices whereas Equator Principles/Green Bond Principles/Global PSSL apply to financial structures (that I call CFDs). It would be confusing and misleading to rely on PRI/UN PRB only for the green bond market or securities lending market. The broad PRI/UN PRB cannot capture the intricacies of complex finance dynamics that rely on the interaction of multiple stakeholders, who often have conflicting interests.

I emphasised this as part of my work as the co-founder and chair of the ISLA Council for Sustainable Finance that provided an initial home for Global PSSL.

.....

B. Securities Lending

1. Objectives and importance

As you know, securities lending is a facilitating financial structure that allows for a temporary collateralised transfer of a security from a lender to a borrower. It is an important mechanism for market liquidity and equilibrium. It has significant potential to influence the environmental, and social and governance (ESG) credentials of asset owners investments. I want to emphasise that, as I analyse the current situation, it is still debatable whether this influence will be positive, negative or neutral.

2. Issues

Securities lending is not a common career aspiration for students who want to succeed in financial services and, as a result, the sector suffers from a limited inflow of fresh and diverse talent. Some of the best securities lending experts I have worked with so far were also experts in trading, investments and broader finance. Hence the overall misunderstanding of securities lending amongst the broader community of professionals and an increased risk of oligopolisation by a small number of stakeholders. In fact, several Global PSSL opening signatories told me that Global PSSL increases trust and confidence in the markets so there is obviously a room for improvement in this area.

3. Securities lending and sustainable finance.

The Sustainable finance agenda has called for serious changes to the financial services industry for many years. Securities lending is, ultimately, a short-term activity with some governance and transparency issues and the sector needs to make greater efforts to align with the sustainable finance agenda. It is not enough to frame securities lending as compatible with ESG. In a similar fashion, one cannot frame unconditional flows of public capital to emerging markets in the name of ‘developmental agenda’.

¹ Joint paper with Nicolas Firzli.

4. Risks and importance of transparency.

Liquidity is extremely important but it is premature to portray securities lending as a wholesome mechanism for the climate change agenda. First, such framing poses an obvious risk of greenwashing and, second, a risk of not improving the 'Governance' part of securities lending in the long-term.

A year ago, this Committee:

"noted that governance considerations should not be an issue for securities lending".²

I need to emphasise that several Global PSSL signatories emphasised Governance as one of the most important reasons for their signature. Also, at the time when Eurex decided to close its lending CCP in early 2021, Matthias Graulich, Member of the Executive Board at Eurex, highlighted that securities lending was "still a bespoke market and less transparent" when compared with repo transactions³

As a lawyer, I am aware that transparency has to be constantly negotiated as there are commercial and prudential reasons to limit it in financial services. Yet, transparency of the securities lending markets is much more pronounced and must be the priority for the whole community of practitioners, including this Committee.

.....

C. Transparency Update

I now turn to my transparency update and let me emphasise our Principle 3 (Transparency) provides clear authority, and consequently, an obligation, for Global PSSL to issue such periodic transparency updates:

"Global PSSL will increase transparency and accountability in securities lending, and the broader area of sustainable finance."

This authority is not embedded in any other generalist principles for sustainable finance (e.g. PRI or UN PRB) so let me rely on this authority or let me know any objections before I continue.

[Pause to respond to any objections]

Thank you – I also remind you about our signatories' commitment to providing accurate information about their sustainable securities lending approaches and activities.

D. Transparency Update II

I shall proceed to the transparency update by following Global PSSL Principles but I will focus on general market trends rather than internal Global PSSL accomplishments. Though, when appropriate, I will refer to our papers which have been issued in the public interest.

² <https://www.bankofengland.co.uk/-/media/boe/files/minutes/2020/securities-lending-committee-november-2020.pdf?la=en&hash=0059FFFEAEDC223B95D32D48C201A64356BC721F>

³ <https://finadium.com/sfm-interview-eurex-to-close-lending-ccp-as-buy-side-repo-growth-accelerates-premium/>

1. Alignment

There are some stakeholders who do not fully appreciate the existence of a principles-led dedicated sustainable finance market standard for securities lending. This will likely trigger a broader discussion on the sustainable finance alignment at the international level.

2. Stakeholder involvement, inclusion and diversity.

This Committee has devoted lots of time to diversity and inclusion, and I applaud these efforts. All stakeholders need to work together with this Committee and individual organisations; embrace efforts by Women in Securities Finance and the Global PSSL Mentorship Programme to make tangible and lasting changes in this space.

Sadly, we also need to intensify our efforts to create the broader stakeholder involvement. Recently, for example, there has been a wider discussion about Global PSSL being inclusive of differing views.

3. Transparency

I devoted much space to transparency above.

4. Interconnected sustainable finance collateral

I have worked on this specific matter for almost three years, initially as part of the working group with beneficial owners. In 2019, we considered the minimum and maximum requirements for collateral in relation to sustainable securities lending. I assigned this task to BlackRock.

There is a clear trend away from emphasising the efficiency/liquidity aspects of collateral towards emphasising the potential ESG credentials of collateral.

However, while collateral is increasingly linked to ESG matters, there are stakeholders that warn of greenwashing risks (see our recent progress report on interconnected collateral).⁴

Global PSSL emphasised safety, liquidity and transparency as part of its standard for interconnected collateral. We drew on the current practice of many organisations, including those represented at this Bank of England Committee.

Given this update, I think it is premature and irresponsible to lobby for environmental elements of collateral prior to solving the potential greenwashing risks. Global PSSL will advocate safety and transparency in the first instance.

5. Supportive tax

We have emphasised tax as part of a minimum forward looking standard for emerging markets (e.g. with Standard Bank and Investec from South Africa).⁵

6. Values-based short selling

We have made much progress in this area, notably our minimum standard on ESG and short activism.⁶

⁴ <https://gpssl.org/wp-content/uploads/2021/10/Progress-report-9-2021-collateral.pdf>

⁵ <https://gpssl.org/wp-content/uploads/2021/09/Global-PSSL-Emerging-Markets-Draft-Standard-14-September-2021.pdf>

⁶ <https://gpssl.org/wp-content/uploads/2021/03/Global-PSSL-Market-standard-on-short-activism-30-March-as-introduced.pdf>

I have drawn on my experience with values-based banks in advancing this area. There is a trend where hedge funds now focus on the broader picture, to include values and ESG considerations in tandem with profit.

7. Voting and engagement

Beyond our principle that invites beneficial owners to perform impact assessments, we are now conducting a more detailed analysis of this matter.

8. Innovation and digitalisation

To quote part of the Principle: "Global PSSL recognises that a broader stakeholder base can provide new solutions and technologies that enhance sustainable securities lending."

Indeed, we observe a market trend where a broader stakeholder base wishes to co-create solutions for sustainable securities lending. Inevitably, this comes down to our Principles on stakeholder involvement and certain trends regarding the exclusive practices of some stakeholders.

9. Continuous improvement

There is a clear trend where regulators recognise the distinction between commercial interests (represented by trade associations) and public community interests (represented by Global PSSL) in the securities lending market. Several regulators have signalled, privately, they welcome hearing a stronger public voice in the debate.

E. Moving forward

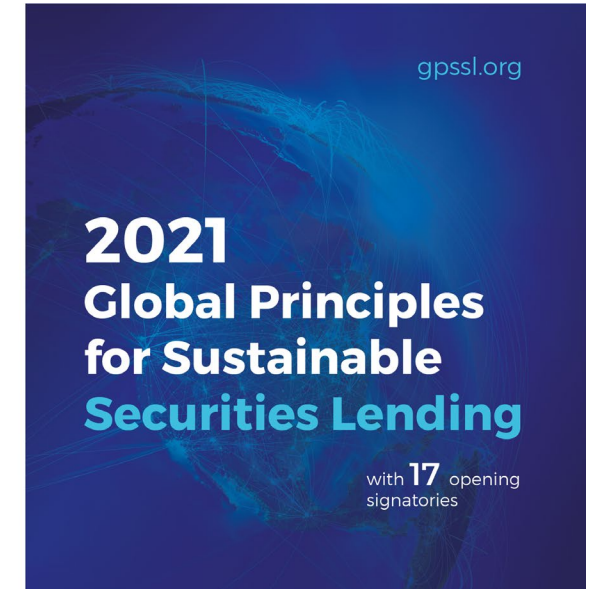
This update forms part of our commitment and authority under the Global PSSL principle on Transparency. I hope you appreciate how the public community interest keeps securities lending grounded in genuine values.

I strongly suggest we deliver further transparency updates on a regular basis to this Committee, either as part of the 'ESG' agenda item or a separate 'Transparency' agenda item. In that event, I would be happy to send out a progress report a few days before future Committee meetings so that attendees have a chance to prepare any questions in advance. I confirm that I will consult the next draft transparency update with international organisations before sending it to this Committee."

Thank you for your time. I look forward to addressing this committee again in the next meeting in the New Year!

-END-

“Sustainable finance principles and securities lending: a transparency update.”



Dr Radek Stech
Founder and CEO, Global PSSL CIC

Status: official presentation at The Bank of England
Securities Lending Committee
4 November 2021

Sustainable finance principles

Nature and importance.

Principles and law.

Principles and sustainable finance:

- top-down approaches;
- bottom-up approaches.



Securities lending

Objectives and importance.

Issues.

Securities lending and sustainable finance.

Risks and importance of transparency.



Transparency update

Authority: Global PSSSL Principle 3:

“Global PSSSL will increase transparency and accountability in securities lending, and the broader area of sustainable finance.”

Commitment to ‘accuracy’.



Transparency update

Alignment.

Stakeholder involvement, inclusion and diversity.

Transparency.

Interconnected sustainable finance collateral.

Supportive tax.

Values-based short selling.

Voting and engagement.

Innovation/digitalisation.

Continuous improvement.



Moving forward



Thank you

I can be contacted at: radek.stech@gpssl.org

Main funders:

